



DEPARTMENT OF THE NAVY

NAVAL SEA SYSTEMS COMMAND
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7640.8 IN REPLY TO
Ser 0153/35
23 Oct 01

From: Commander, Naval Sea Systems Command
To: Assistant Secretary of the Navy (Financial Management and Comptroller)
Subj: CONVERTING COST REIMBURSABLE PROJECT ORDERS TO FIXED-PRICE AGREEMENTS
Ref: (a) DoD Financial Management Regulation (FMR) Volume 11A

1. The purpose of this letter is to formally forward our request to eliminate the reference (a) requirement to convert a cost reimbursable project order to fixed-price agreement before reaching 50 percent of either scheduled time or predicted cost. This is an action item we mutually agreed to during a follow-on meeting in April on actions required to comply with PORT Report recommendations on the use of project orders for ship maintenance work.

2. Reference (a) states that cost reimbursable project orders may be converted to a fixed-price basis, provided all of the conditions governing the use of fixed price project orders are present. As such, it requires definite specifications, no substantial contingencies, and a satisfactory cost estimating system that is consistently applied. In addition, reference (a) provides that the conversion must occur prior to incurring 50 percent of the total cost of the work, or 50 percent of the period of performance, whichever comes first.

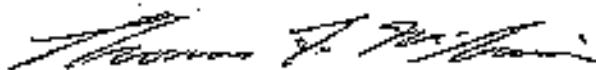
a. The context makes it clear that the purpose of these restrictions on fixed pricing is to ensure that the working capital fund is not subject to unwarranted financial risks. We believe that the requirements related to specifications, contingencies, and cost estimating systems are themselves adequate to ensure that no undue risk is present. Indeed, if conversion of a project order from cost reimbursable to fixed priced occurs after the passage of 50 percent of cost or time, the risk is actually lower than if the conversion occurs earlier. It follows that the 50 percent restriction does not serve a significant or useful purpose in protecting the financial solvency of the working capital fund.

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b. At the same time, the ability of the fund to provide a fixed price arrangement for ship maintenance work does provide our Fleet customers with significant financial management advantages. When they can be assured of the full extent of their financial exposure on previously ordered shipwork, they more precisely plan the execution of the remaining budgeted work. As the end of a fiscal year approaches, the need to hold a contingency could result in a decision to cancel planned and budgeted work. As a result, the Navy benefits by fuller utilization of available funds.

c. Third, there is a particular need for this relief in the case of ship repair. Specifically, for shipwork of longer duration, it takes time for the shipyard and customer to define the work to the point where there are no substantial contingencies, as doing so often requires partial disassembly and inspection. Performing partial disassembly and inspection then documenting the resulting work package frequently involves tasks that extend beyond the time when 50 percent point of the work would have occurred. For shipwork of short duration, the length of performance may not allow for the conversion within the time frame. In both cases, despite being in a position where a fixed-price agreement is advantageous to both the performing activity and the customer, the "50 percent rule" arbitrarily deprives the Department of reaching a fixed-price agreement.

3. In summary, the non-statutory "50 percent" requirement represents a business practice that is not consistent with private industry practice, working capital fund financing risks, or needed ship maintenance program execution flexibility. Having definite specifications, no substantial contingencies, and a satisfactory cost estimating system provides sufficient guidelines for ensuring appropriate conversion of cost reimbursable project orders to fixed-price agreements. I therefore request your assistance in eliminating the "50 percent" requirement from the DoD FMR as detailed in reference (a).



T. F. MCGUIRE
Comptroller/Deputy Commander

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